

No. 16,127 ✓
United States Court of Appeals
For the Ninth Circuit

EDWARD J. BLOOM,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

APPELLANT'S PETITION FOR A REHEARING.

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*To the Honorable Richard H. Chambers, Chief Judge
and the Associate Judges of the United States
Court of Appeals for the Ninth Circuit:*

Comes now the appellant and respectfully begs this Court to grant a rehearing of the above-entitled cause, and in support thereof respectfully shows:

PRELIMINARY STATEMENT.

On page 10 of the opinion this Court relies upon this Court's recent decision in *Wilson v. U. S.*, 250 F. 2d 312. The distinction which we argue this Court has missed entirely in its opinion is just this: "Ap-

pellant was chief executive officer of the corporation. It was his responsibility to determine how *corporate* funds should be expended." But the uncontradicted testimony was that all of the money in corporate accounts was trust money, i.e., money released to appellant and Idaho Smelting, Inc. under the Uniform Trust Receipts Act. Over such funds appellant or the corporation of which he was chief executive officer had no control whatever. Further to divest the corporation of any capacity to exercise *any* judgment or election as to what bills should be paid and when, the record shows that the bank extended overdrafts to Idaho Smelting up to \$54,000 monthly and that overdrafts, (i.e. the absence of any funds in the corporate accounts) extended throughout the latter part of 1947 and all of 1948. (Exhibit K.)

It is apparent from examination of Exhibit K that no funds were actually collected and withheld by Idaho Smelting Inc., or appellant, and that the tax returns made were computations of the tax that should be paid from the same source that paid the wages. Since this source was an overdraft, no actual money was in the hands of Idaho Smelting, Inc., or appellant, and it is uncontradicted that the bank would have had to approve and pay such an overdraft, and that they failed to do so. If there was occasionally a few dollars it was covered by a trust receipt and belonged to the bank. There can be no contradiction of appellant's positive testimony that the bank refused to authorize such an overdraft by the bank officers' testimony that they had destroyed all their

records and had no personal recollection of such refusal.

Therefore the Court's opinion that there is any conflict whatever in the testimony is wholly incorrect in the light of the whole record and its exhibits, and the opinion of the trial Court is clearly erroneous as a matter of law.

By the terms of this decision, appellant is found liable for a penalty under the Internal Revenue laws for *not* doing something (paying corporate withholding taxes) when by the laws of the State of Washington he would have been *criminally* liable for a prosecution for embezzlement if he had done so from proceeds of trust receipt financing.

Such is not and cannot be the law. Surely the taxpayer-citizen must have some means of engaging in legal business activity under time-honored trust receipt methods of financing without being forced to choose between the Scylla of personal income tax penalties for corporate obligations and the Charybdis of state criminal prosecution.

The Court correctly states on page 2 of its opinion that

"The terms of the financing agreement . . . required the Corporation to buy and sell aluminum on a trust receipt basis." (See also Exhibits A, B & C.)

The entruster's (bank's) interest in a trust receipt transaction is a property interest unaffected by Federal tax liens or attachment liens against property

of the trustee. The object of the Uniform Trust Receipt Act is to standardize and protect the trust receipt method of financing the acquisition and resale of goods in their journey from producer to retailer. See headnotes 6 and 10, *Commercial Credit v. Bosse*, 283 P. 2d 937, and text. The deposit of proceeds to the account of the corporation did not change the trust character or deprive the entruster of its rights therein. Entruster's interest in the proceeds is a property interest and not a lien. *Commercial Credit v. Bosse, supra*.

The Court's attention is also called to Judge Hamley's opinion in *Maulding v. U. S.*, 257 Fed. 2d 56 and cases cited therein, for further definitions and explanations of trust receipt transactions.

Appellant submits that this Court correctly found that Idaho Smelting, Inc., was engaged in the aluminum business on a trust receipts method of financing but failed to consider fully the legal, fiduciary, trust, and economic factors arising out of that relationship. A standard form of the trust receipt used by Idaho Smelting is incorporated in this record on appeal as Exhibit "D". The specific provisions of this document, binding upon Idaho Smelting, Inc., and the appellant as an officer and director are as follows:

Trust Receipt

The undersigned (hereinafter called the "Trustee" within the meaning of the term as defined by the Uniform Trust Receipts Act of the State of Washington) hereby acknowledges receipt from, and the holding in trust for, Seattle Trust and

Savings Bank of Seattle, (hereinafter called the "Entruster" within the meaning of the term as defined by the Uniform Trust Receipts Act of the State of Washington) of the goods, documents and/or instruments specified below, and agrees and acknowledges that a security interest in said goods, documents and/or instruments, and in any goods represented by said documents and/or instruments, remains in, or will remain in, or has passed to, or will pass to, the Entruster. Said goods, documents and/or instruments secure an indebtedness . . . owing to Seattle Trust and Savings Bank of Seattle, at its Main Branch, together with interest thereon in accordance with the terms of the credit, agreements, draft or note evidencing said loan and all indebtedness for which the goods, documents or instruments hereinbelow described, or any of them, were security before the trust receipt transaction evidenced by this instrument. . . .

. . . In consideration of such receipt and other valuable considerations, the Trustee agrees to hold said goods, documents and/or instruments in trust for the Entruster and subject to its security interest, to be used promptly by the Trustee without expense to the Entruster for the following purpose(s) checked below but for no other purpose(s) and without liberty to hypothecate, mortgage, pledge, assign or make any other disposition of the same or, unless hereinafter expressly provided, to sell the same:

1. To transfer to carrier.
2. To transfer to warehouse.
3. To deliver said goods to . . . who have/has agreed to purchase the same.

4. To sell said goods, subject to the following limitations (if any).

5. To manufacture or process said goods and to sell the same, whether or not manufactured or processed.

6. *

The Trustee agrees to account by delivering to the Entruster immediately upon receipt thereof by the Trustee, . . .

. . . The Entruster shall have full power to compromise and collect such proceeds in its own name or that of the Trustee. *The Trustee agrees that all proceeds of the sale or exchange of said goods, documents and/or instruments or any of them, if, as, and when said proceeds are received by Trustee, shall be held by the Trustee in trust for the benefit of the Entruster and the Trustee agrees to promptly account and pay to the Entruster all of said proceeds. . . .*

The Trustee agrees to pay all expenses and charges in connection with said goods, documents, instruments and any proceeds thereof, and will at all times while the same are in its hands hold said goods, documents, instruments *and proceeds* separate and distinct from any property of the Trustee and capable of identification and will definitely show such separation in all its records and entries. . . . The Entruster shall have the same security interest in any additions or improvements to goods as it had in the goods themselves. . . .

The Trustee agrees to deliver to the Entruster, on demand, accurate records and copies of all accounts with respect to said goods, documents, instruments *or proceeds thereof* and to execute

any assignments or other documents in connection therewith which the Entruster may require, and *the Trustee further agrees that there will be no offsets or credits against any claims or accounts constituting proceeds of said goods*, documents or instruments and guarantees payment of said claims and accounts in full.

. . . No waiver of any rights or powers of the Entruster or consent by it shall be valid unless in writing signed by the Entruster. No waiver of any existing default shall be deemed to waive any subsequent default, and all rights hereunder are cumulative, and not alternative, and are in addition to any rights given by law to the Entruster. In the event that the Trustee may have other trust receipt transactions with the Entruster, the default of the Trustee in the payment of any obligation to said Entruster secured by this or any other trust receipt transaction, will cause all indebtedness of the said Trustee to said Entruster, at the option of the Entruster and without notice to the Trustee, to become due and payable, irrespective of any maturity dates provided for in the obligations evidencing said indebtedness.

From the above terms, it is obvious that Idaho Smelting, Inc., and the appellant had no leeway—no discretion—as to the use or control of the funds of the bank released to it in trust and on deposit in the account of Idaho Smelting, Inc., in occasional liquidation of the overdrafts without the express consent of the bank. And, as is amply borne out by the record, throughout 1948 the bank was primarily, if not solely, interested in satisfying the corporation's

liabilities to it. (Exhibit L.) This Court implies on page 9 of its opinion that funds *were* available for the payment of these taxes and that the bank would have approved the payment of them if only so requested by the corporation. On the contrary, the entire course of the corporation's affairs from September, 1947, as revealed by the documentary evidence (Exhibits L, M, N, O and U), and the uncontradicted testimony of appellant (T. R. pp. 79 et seq.), the bank officials (Depositions of Baillargeon and Winslow) and the corporation's officers (Depositions of Salyer and Thompson) discloses that the bank was justifiably concerned about the substantial loans outstanding which had been jeopardized by the collapse of the metal market; that pressure was thereupon placed upon the corporation to liquidate its large inventory held under trust receipt at depressed prices; that they persuaded other creditors to accept debentures rather than cash; and that the appellant much later attempted to "bail out" the corporation through use of his personal funds even though he was not obligated to do so. There is no place in the record where there is any concession by any witness that funds in corporate accounts or control were not covered by trust receipts.

The entruster's (bank's) interest in a trust receipt is an absolute property right; at all times pertinent to the withholding taxes in question the bank actually had *title* to the funds of the corporation (see Exhibit "D"). The corporation itself was merely a trustee for the bank, and could take no action concerning

such funds without the bank's consent. The bank's interest in the funds was absolutely unaffected by the existence of Federal tax liens or attachment liens against the property of the trustee.

This Court in *General Motors Acceptance Corporation v. Kline*,¹ held that title to the property held under trust receipts was in the financing institution, and that the legal effect of the trust receipt is to be determined by state law.

The Supreme Court of Idaho, *Commercial Credit Corporation v. Bosse*² (in which the United States, among others, appealed from a judgment in favor of the entruster) stated on page 939:

"Appellant, United States of America, does not contend that it had a (income and withholding) tax lien on the automobile superior to the rights of respondent."

The Court then held:

"Having determined that the security interest of respondent in the funds held by appellant sheriff is a property right, it follows that respondent was entitled to maintain its action in claim and delivery to recover such proceeds. Such property right was at all times present in such proceeds and is unaffected by any of the tax liens or attachment liens of appellants against the property of Bosse Motor, Inc."³

¹78 F.2d 618 (CCA 9th, 1935).

²283 P.2d 937 (1955).

³*Id.* at p. 941.

As an officer of Idaho Smelting, Inc., the appellant was in a fiduciary position in relation to the bank. If he had taken it upon himself to disburse the *bank's funds*—and all of the income of the corporation was such during this period—then he would have been liable, both civilly and criminally for this misappropriation and embezzlement. (Under Washington statutes, R.C.W. 9.54.010, a trustee may be imprisoned for just such an act of larceny.) Appellant was not privileged by his position as president of the company to take funds *belonging to someone else* and apply them to corporate debts any more than any other trustee, guardian, or executor. Once this basic fact of trust receipt financing is acknowledged, it is obvious that the judgment appealed from is clearly incorrect on two grounds.

First, that appellant was not, and could not have been under the circumstances, the “person” whose duty it was to account for and pay over the corporation’s taxes when he had no control over the disbursements.

Secondly, the corporation’s and appellant’s legal rights and obligations under this trust receipt system of financing preclude any conceivable holding that appellant “wilfully” failed to pay such taxes within the meaning of Section 2707(a).

How may a person be penalized for “wilfully” failing to pay taxes when he not only did not *own* the funds allegedly available to pay them or have any power or authority to disburse them, except as

checked by the terms of the trust receipt, but also would have been guilty of a breach of an express fiduciary relationship and criminally liable for larceny if he had done so?

Obviously, if appellant had turned the entire corporation over to the bank at the time the withholding taxes were first unpaid, or if the corporation had elected to undergo bankruptcy, no question would arise of appellant's liability now. He is now being penalized for this error in judgment in attempting to weather out the depressed metal market of the late 1940's in the hope that after his trust obligations to the bank had been satisfied, he would be able to reactivate the enterprise and make good the corporation's debts to the government and other creditors. If appellant had used *corporate* funds for other purposes than taxes, that election so to do might subject him under current cases to penalty; but use of the bank's trust funds in the corporation account is NOT in any sense the same thing as the use of "corporate" funds. See *Commercial Credit Co. v. Bosse*, 283 P. 2d 937, 941, *supra*.

Although appellant raised timely objections during the trial and stressed the penalty nature of this proceeding by the government in his brief,⁴ this Court did not consider in its opinion the serious constitutional question of the manner in which the penalty was imposed in this case. As previously stated appellant sought to obtain a hearing in the Tax Court

⁴A.O.B. pp. 21-23.

after the assessment in question had been levied. That Court dismissed his petition, with the opinion that the matter in suit was a penalty over which the Tax Court had no jurisdiction. (Exhibit V.)

As appellant was not financially able to pay this penalty and then sue for a refund, his two District Court suits having been dismissed, he had no way of challenging or removing the liens against him until the government instituted this suit over six years later. The facts are undisputed and the government does not challenge appellant's statement that it relied upon its arbitrary *penalty* assessment made without notice or opportunity of a hearing—as establishing a *prima facie* case, thereby shifting completely the burden of proof to the appellant. Certainly there is no question but that appellant was prejudiced by the trial Court's denial of his motion to dismiss based on such grounds, in a case involving disputed issues of fact. Both the above mentioned tax Court decision (Exhibit V) and *Enochs v. Green*⁵ recognize that the amounts involved here are a *penalty*, rather than a *tax*.⁶ Respondent has cited no authority in the Code, Regulations, or case law—and appellant knows of none—which stands for the proposition that a mere *assessment* of a *penalty* is sufficient to establish a *prima facie* case for the Government. See also the minority opinion in *Enochs v. Green, supra*.

⁵270 F. 2d 558 (C.C.A. 5th, 1959).

⁶This is doubtless the reason the Government brought suit against appellant, rather than proceeding by way of distraint or jeopardy assessment.

THE COURT DID NOT CONSIDER THE CONSTITUTIONAL
QUESTIONS RAISED BY APPELLANT.

Appellant submits that this Court did not consider in its opinion the constitutional objections to Section 2707(a) as applied in this case. The basis of appellant's contention in this respect is that there is *no* constitutional authorization or power for the *ex parte* assessment of a penalty under these circumstances, and that if 2707(a) purports to grant the Director of Internal Revenue the power to make and collect such a penalty "in the same manner as *taxes* are assessed and collected" it is unconstitutional and void as an arbitrary and capricious exercise of the taxing power and deprives the appellant of property without due process of law.

Further, appellant raised due process objections to the manner of assessment and the manner in which the District Court conducted the trial in that the burden of proof of *disproving* a *penalty* was imposed upon him as the *defendant* in the civil action. The Government relied completely on their assessment as sufficing for a *prima facie* case (T. R., Vol. II, pp. 16-17). Contrary to the statement of counsel for the Government on page 17 of Volume II of the transcript, there is *no* law supporting such a proposition in respect to a penalty.

PRAYER.

For all of the reasons hereinabove set forth appellant respectfully prays that this Court set the case down for reconsideration and rehearing; and in the event the Court fails to do so appellant respectfully prays that the Court stay its mandate pending the filing by appellant of a petition for certiorari in the Supreme Court of the United States and pending disposition by that Court.

Dated, San Francisco, California,
December 30, 1959.

Respectfully submitted,

JAMES W. HARVEY,

DOROTHY E. HANDY,

*Attorneys for Appellant
and Petitioner.*

CLARK A. BARRETT,
Of Counsel.

CERTIFICATE.

We, James W. Harvey and Dorothy E. Handy, attorneys for Edward J. Bloom, the appellant herein, and Clark A. Barrett, of counsel, certify that this petition is presented in good faith; that it is not interposed for delay; and that in our judgment it is well founded.

Dated, San Francisco, California,
December 30, 1959.

JAMES W. HARVEY,
DOROTHY E. HANDY,
CLARK A. BARRETT.

